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SUBJECT: NEW CABINET MINISTERS TACKLE ECONOMIC REFORM

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¶11. (SBU) SUMMARY: The new ministers of finance, telecommunications, and energy were enthusiastic about taking on key reform priorities outlined in reftel during separate meetings with the Ambassador the week of January 4. All three ministers were confident the GOL would pass a budget in 2010 for the first time in five years, and all were optimistic that in the current political environment they would be able to move forward quickly on reform. Minister of Finance Raya el-Hassan said the budget was her top priority, and she was looking for ways to bring more spending into it while continuing the long process of making it a more transparent document.

¶12. (SBU) Telecoms Minister Charbel Nahas said that privatization of the mobile phone companies would take time, but he planned to provide more transparent accounting of all GOL-owned telecom providers while expanding broadband access in 2010. Minister of Energy and Water Gebran Bassil stressed the importance of investment and strategic planning in the electricity and water sectors, while exploring the possibility of finding oil and gas off the Lebanese coast. All three ministers were considering the fiscal impact of reform, both positive and negative. Meanwhile, both the finance and telecom ministers encouraged the USG to explore alternate conditionalities for the disbursement of the final \$75 million tranche of USG-pledged Paris III budget support. End SUMMARY.

FIRST PRIORITY: THE BUDGET

¶13. (SBU) Finance Minister Hassan said submitting the 2010 budget was her top priority, but she was still awaiting budget submissions from the fiscally crucial ministries of telecommunications and energy. She noted that the ministerial statement had outlined an ambitious agenda for the new government, and she worried about where she would find funds to jumpstart the economy and "bring growth to the people." She was particularly concerned about the budget impact of new projects in the electricity sector. Nonetheless, once she receives all the submissions, she expects to be able to present the comprehensive document to the cabinet within a few weeks, where it should pass after several weeks discussion, moving on to the parliament perhaps sometime in March.

¶14. (SBU) Telecoms Minister Nahas was also focused on the budget, promising that his submission would be in shortly, and he hoped that the GOL would be able to pass the full budget reasonably quickly. Energy and Water Minister Bassil

also indicated his budget submission would be in soon, and that he was working hard to give a fair representation of the funding needs of his ministry, which has responsibilities ranging from electricity production to administration of dams to oil and gas exploration.

BRINGING TRANSPARENCY TO THE BUDGET

15. (SBU) The Ambassador raised USG concerns about the lack of transparency in the GOL budget, and the congressional mandate that USG assistance go only to central governments with transparent budgets. Hassan said she would be happy to accept help from the USG in this area, though there would have to be careful coordination among donors as the World Bank had just started a wide-ranging project covering budget preparation and execution. Meanwhile, she assured the Ambassador, she was looking for ways to include more GOL spending in the 2010 budget. Later in the week, the minister encouraged a delegation from the U.S. Treasury Department's Office of Technical Assistance (OTA) to look into assisting the ministry's public accounting unit. The unit's mandate includes closing the accounts of Lebanon's so-called "public institutions," many of which are not currently accounted for in the budget.

16. (SBU) Minister Nahas stressed that the delay in his ministerial budget submission was the result of his efforts to account more carefully for revenue and spending in the publicly-owned mobile and fixed-line sectors. He hoped that more rigorous accounting would make clear the source of revenues in the telecom sector, showing the degree to which taxation and monopoly rents pad the earnings of the sector on behalf of the GOL.

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TELECOM PRIVATIZATION WILL "TAKE TIME"

17. (SBU) Nahas asserted that a clear breakdown of income and spending, as well as accounting for depreciation of assets, was essential to the process of privatization, particularly in the mobile sector. Privatization would therefore "take time," and the structure of privatization, whether through a straight license auction or some sort of public offeringt"V6Q U4sBtQ^Cw!2hange, would need to be discussed in cabinet. In the fixed-line sector, he worried that corporatization of the government-owned Ogero in its current form would merely create a monopoly that would crush competition. He said he wanted to explore breaking the company into its constituent parts before creating Liban Telecom, which might use its control of network infrastructure to push out competitors.

18. (SBU) While he sorts through these accounting and structural issues in 2010, Nahas said he would move forward immediately on expanding internet bandwidth and setting up broadband sites around the country. This would "show the people that the state can do something for them," he said, while the groundwork is laid for privatization.

ELECTRICITY AND WATER:
"ANYTHING WE DO IS BETTER THAN NOTHING"

19. (SBU) Bassil was still getting a handle on his vast portfolio, but said his preliminary analysis led him to conclude that there has been too little investment in the electricity and water sectors in Lebanon, and it was important that the government take action immediately. "Any decision we make will be better than no decision at all, as we have seen for the past few years." He pointed to the regional water authorities, which he said had been created and then starved of material and human resources, resulting in low collections and massive deficits. "We have water, we

just need to manage it better," and he thanked the Ambassador for USAID's support to the water authorities, as well as to municipalities, with whom AID has worked to build waste water treatment plants. Bassil believed Lebanon needed to invest in dams, to preserve scarce water resources and open up opportunities for hydroelectric power.

¶110. (SBU) Bassil spoke briefly about the possibility of meeting short-term power needs by purchasing electricity from Lebanon's neighbors. While Syria and Egypt do not have much more to sell, he said, Turkey might have an excess, which might help Lebanon take in the 600MW it needs to make it through next summer. As for a longer-term solution to the supply problem, he stressed that the GOL must build new power plants, and he was looking into funding options. Meanwhile, he hoped to focus on demand management, encouraging people to use energy-conserving light bulbs, and on exploring alternative energy options. When asked if he was looking to decrease the subsidy on big consumers of electricity, he replied enthusiastically, "Yes! I will do it. We should not be in the business of subsidizing the rich."

¶111. (SBU) Without giving details on his plans, Bassil said he wanted to pursue oil and gas exploration off Lebanon's coast, and if resources were found he would recommend that proceeds from them be put into a special fund, much as Norway does with its energy revenues. Discovery of natural gas could open the way to using more gas in electricity production, which would bring down costs significantly, he noted. He added that he was in favor of corporatization of Electricite du Liban (EDL), the state-owned power utility, but that he would need to learn more and discuss with cabinet colleagues before moving forward.

FISCAL CONCERNS

¶112. (SBU) Bassil acknowledged that he would be asking the central government for money to invest in improvements in water and electricity. He claimed that such investment, even if it raised the deficit in the short term, would yield returns very quickly, lowering costs in the coming years and improving Lebanon's fiscal situation. Meanwhile, his talk of increasing the use of natural gas and raising electricity prices for large consumers would certainly stem EDL's losses, which amount to over \$1 billion annually. Finance Minister

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Hassan was emphatic that any additional spending must be funded either through donor contributions or an increase in taxes, because "I won't let them mess with my debt-to-GDP ratio," she said. Nahas argued that increased liquidity in Lebanon's banks opened up breathing space for the GOL to take on fundamental reforms of the public sector without resorting to the "emergency approach" of slashing budgets and selling off assets, though he stressed that privatization was an essential part of his strategy.

PARIS III: CHANGE IN CONDITIONALITY?

¶113. (SBU) COMMENT: Both Hassan and Nahas supported the idea of extending the Paris III cash transfer MOU between USAID and the Ministry of Finance until December 2010, but both also broached the subject of changing its conditionalities. While privatization of the mobile companies is still a priority for the GOL, it is not likely to happen in 2010, and when it does, it looks increasingly like a public offering of some sort may be the preferred structure. We can follow up with Nahas on his plans in detail, both on structure and timing. Meanwhile, in order to send a strong message of support to the new government as it takes on reform in earnest, we would like to open up an interagency discussion on the possibility of changing the final condition on our budget support. Hassan and Nahas both mentioned linking the assistance to reform in the broadband sector, with the

finance minister pointing to a broadband license auction as a possible benchmark. If we choose to stay with mobile privatization as a condition, we may have to consider altering the language to allow alternative transactions, rather than only a license auction, while extending the deadline beyond 2010.

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